# Advisers build

*Continued from page 21*

First Quadrant Corp., Morristown, N.J., has adapted techniques used in domestic tactical asset allocation to produce a purely quantitative investment vehicle.

The firm's executives argue investors know the prospective long-term returns for various asset classes: the yield on cash equivalents and the yield to maturity on long bonds provide proxies for total rates of returns, while prospects for equities are measured by earnings yield, dividend yield or consensus-based dividend discount models.

There are normal or equilibrium levels among these assets classes, they contend. When returns stray, markets forces return them to the equilibrium, thus providing an opportunity to profit.

"Expected returns on different asset classes adjusted for the appropriate risk premia and stated in a common currency (i.e., after adjusting for exchange rate changes) should be equal. If they are not, arbitrage opportunities will cause investors to pull them back into line," wrote Robert D. Arnott and E. George Matthew, president and vice president respectively of First Quadrant in a draft report to clients.

First Quadrant also hedges currency risk except when it has reason to believe returns will be high enough to justify the risk.

Acadian Asset Management Inc., Boston, also employs a tactical asset allocation strategy, based on country selection that uses nearly 20 variables for every major world equity market.

The firm also offers a quantified active stock selection strategy, based on a multifactor approach including p/e ratios, price-book value ratios, price-sales ratios, price momentum factors, consensus earnings forecasts and dividend-discount model valuation. In its small-capitalization stock strategy, Acadian adds a small-cap tilt to the other techniques.

DSI International Management Inc., Stamford, Conn., is a newcomer to money management but its parent, Decision Services International, has provided quantitative research for financial institutions for more than 15 years. It screens a universe of 2,500 stocks for a variety of factors, such as relative dividend yield, relative earnings yield and price to book value. It also adjusts for the volatility of each of the stocks, coming up with a combined ranking. In less than a year's time, it has pulled in $100 million in assets, including an account from the $8.2 billion Lockheed Corp. pension fund, Calabasas, Calif.

Parametric Portfolio Associates Inc., Seattle, Wash., employs quantitatively derived active tilts to enhance returns.

Similarly, County NatWest Investment Management Ltd., New York, offers a variety of tilts on index funds, as well as active-passive approaches and currency protection strategies that promise to hold foreign exchange losses to a specified target level.

On the bond side, Quantitative Asset Management Group, Chicago, a 3-month-old unit of Drexel Burnham Lambert, uses an economic model that first sets a country allocation, picks cheap sectors and selects the most underpriced issues, said Fred Arditti, president of the firm and formerly chief economist of the Chicago Mercantile Exchange.

Other money management firms that use quantitative techniques overseas include Grantham, Mayo, Van Otterloo & Co. International, Boston; PCM International, Newark, N.J.; Boston International Advisors Inc., Boston; Intech/Paribas Asset Management, New York; Roll and Ross Asset Management Corp., Blue Bell, Pa.; InterQuant Capital Advisors Ltd., New York; Mercator Asset Management, Fort Lauderdale, Fla.; State Street Bank and Trust Co., Boston; Dimensional Fund Advisors Inc., Santa Monica, Calif.; Nikko Capital Management (U.S.A.), New York; Bankers Trust Co. — Investment Management Group, New York; and Wells Fargo Investment Advisors, San Francisco. ■

— *Joel Chernoff*

# Irish firm plans U.S. ventures

CHICAGO — The Bank of Ireland's asset management unit expects to set up joint ventures with about six U.S.-based money managers to offer international investment management to U.S. pension funds.

According to Gerald Colleary, senior vice president of the unit, IBI International Investment Services Ltd., said agreements with several firms are near.

He declined to name them until the agreements are completed. "I expect they will all be completed by the end of the year," he said.

Mr. Colleary set up IBI International's Chicago office last summer to serve as the base for its U.S. marketing.

IBI International is a unit of Investment Bank of Ireland, which is wholly owned by Bank of Ireland, one of the two largest commercial banks in the Irish republic. All three of the companies are based in Dublin.

IBI International has $3 billion under management, all from foreign-based clients, about half of the $3 billion is from Irish-based pension funds.

Although it has no domestic U.S. clients, IBI International manages assets for Ireland-based subsidiaries of U.S. companies, including IBM Corp., C.R. Bard Inc., Squibb Corp., Baxter International Inc., Bausch & Lomb Inc., National Can Corp., Computer Products Inc., Zenith Electronics Corp. and Square D Co.

Mr. Colleary said IBI International's joint ventures will target midsize pension funds, both corporate and public, and other tax-exempt institutions, all having $50 million to $500 million in assets. He said these sponsors appreciate diversification, but have been largely neglected in marketing by international asset managers.

IBI International will invest in non-U.S. securities. He said IBI International prefers balanced accounts with full discretion to determine the asset allocation of the portfolios.

He said IBI International sought the joint ventures after deciding it would be a long, costly effort to set up its own marketing organization in the United States.

The joint ventures "save us from having to acquire marketing expertise," he said. The partners will "know their regional market and they will already have a client base."

The joint ventures offer advantages to the managers as well, he added.

"The manager can now offer global management services and not just domestic management," he said, making them more competitive in their regions.

Each of the joint ventures, along with IBI International's Chicago office itself, will market nationwide without territorial exclusions.

Mr. Colleary, now the office's only executive, expects marketing overlap to be minimal because of the vast size of the U.S. market, although any obvious duplications, such as the joint venture partners having the same clients or prospective customers, will have to be worked out beforehand.

Mr. Colleary said IBI International will not refer its Irish and other European clients to the U.S. managers for U.S. investment services, because it already manages U.S. investments for them. ■

## UPDATE

*Continued from page 21*

turns will be limited by a flattening of the yield curve, slowing corporate profit growth with few surprises and competition from foreign markets, the report said.

The main buyers of U.S. stocks in 1988 have been corporate insiders: corporate buybacks or acquisitions of shares of other companies, leveraged buy-outs and raider activity. Salomon expects this activity to continue in 1989.

### Irish fund plans hires

DUBLIN, Ireland — Ireland's Electricity Supply Board is going to outside money management for its $525 million pension fund.

The government-owned utility has been under pressure to trim its management ranks, resulting in a three-week white-collar strike in November. The impending retirement of senior pension fund officials has led the utility to seek external managers.

The fund's asset mix now is 50% in gilts or local bonds and 35% in domestic stocks, with the balance spread among property, overseas equities and cash equivalents.

The new asset mix is not expected to be significantly different, said Colin Lever, senior partner at London-based Bacon & Woodrow Investment Services Ltd., which is advising the fund on investment strategy. Mr. Lever said the fund probably will hire three managers: one each for domestic equities, domestic fixed income and overseas securities. He added, however, the fund's trustees are considering establishing a passive core portfolio.

William M. Mercer Fraser Ltd., Dublin, is conducting an actuarial study of the fund, Ireland's third largest.

Managers are expected to be hired "over the next few months," said Brendan Clear, pensions manager.

### Managers set for '92

LONDON — With investors' attention focusing on the dropping of trade and other barriers in the 12-nation European Community in 1992, it's only natural money managers come up with products designed to take advantage of the changes.

Recently, two managers have rolled out small-capitalization equity funds designed to take advantage of the changes.

Chemical International Asset Management, London, is offering its "Europe 1992" fund, which invests in stocks with less than $500 million in capitalization that stand to benefit from the changes.

"One of the bigger problems we've had to overcome is that there is not nearly so much research here on small-cap stocks," said Alan Pendleton, chief investment officer for the Chemical Bank subsidiary.

The four portfolio manager/analysts who run the new fund, which has garnered about $10 million in assets, look very much at demographic trends, such as the large labor force available in southern Europe.

Chemical officials hope the fund will grow to $100 million, and to a portfolio of 200 stocks selected from a universe of 500 companies.

For now, it has 40 holdings, including **Ava**, a German discount retailer; **Hage Meyer**, a Dutch diversified trading company; **Kwik-Fit Holdings PLC**, a British auto parts retailer; and **Cristaliera Espanol**, a Spanish glass company.

Meanwhile, Review Management Corp., Fort Washington, Pa., is offering the first actively managed, open-end mutual fund investing in European small-cap stocks.

The fund will be managed by Bruno Bertocci, a portfolio manager in the London office of Rockefeller & Co., the subadviser.

"As a group, small stocks are underowned on an institutional basis" in Europe, said Richard E. Smith III, president of Review Management, which also oversees the $290 million Over-The-Counter Securities Fund.

Mr. Smith plans to target small to midsize pension funds, with up to $1 billion in assets. Charges to investors are capped at 2.25% of assets.

### Firm expands service

REIGATE, England — R. Watson & Sons, a leading British actuarial firm, has formed a pan-European financial consulting service, Watsons Europe.

The service will offer professional advice to insurance companies and employers on employee benefits.

"Most people only talk about the opportunities associated with 1992, but it will present real headaches for companies with workforces in different European countries," Michael Bell, a senior partner in R. Watson & Sons and chairman of EURACS, explained in a news release.

### Capel opens office

James Capel, the London-based global investment house, is opening a Los Angeles office of its North American subsidiary, James Capel Inc., to provide West Coast investors with investment research and brokerage services in international securities.

# Quants eye global arena

*Continued from page 21*

$170 million in assets.

Dramatically reduced trading costs are making active management strategies more feasible as well, Mr. Bergstrom said. Trading costs have dropped to less than 50 basis points from two to six times that amount 10 years ago, he said.

Also important to pension executives is the ability to retain control over the investment strategy and risk parameters of their funds.

Some observers, however, question how much risk can be controlled on the international side, given the volatility of currencies and other factors.

Numerous pension executives are constructing international index portfolios as a core investment strategy with satellite managers as a way of providing further diversification and lower risk. The $1.6 billion Philadelphia Municipal Pension Fund hired a core index manager, two active managers and a small-capitalization manager to run 9% of its assets in international portfolios (*Pensions & Investment Age*, Nov. 28).

Quantitative investment management styles may have their drawbacks too.

Nicholas Carnes, senior portfolio manager at CIGNA International Investment Advisors Ltd., London, said, "Quantitative techniques were developed to deal with the natural sciences where reasonably stable relationships

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# Volume

*ontinued from page 2*

4.4% of the market. Salomon rothers (1987's top debt unerwriter), Merrill Lynch, First oston and Morgan Stanley & ., ranked second through fifth.

Prudential-Bache Capital unding made significant adances in initial public offerings, on-investment grade debt and ommon stock from very small olumes the previous year. This elped the firm jump to eighth lace from 10th in the domestic ebt and equity rankings.

James F. Crowley, co-head of vestment banking of Prudenal-Bache Capital Funding, said st year's growth was propelled y a build-up in high-yield capalities and a strong retail netork that capitalized on the rowth in closed-end funds.

Underwriting volumes in most ectors declined in 1988. Non-inestment-grade debt totaled 27.813 billion, down from 29.026 billion the previous year. itial public offerings volume ipped to $23.328 billion from 24.188 billion, and common tock underwritings volume lummeted to $29.6 billion from 41.674 billion.

Wall Street's top five firms held combined domestic market hare of 60.8% in 1988 compared ith 63.4% in 1987. Worldwide, he top five — all U.S. firms — eld 41.3% of the market share ompared to 45.6% in 1987.

Goldman, Sachs charged to first lace in mortgage-related issues, oubling its volume to $16.887 illion from $8.409 billion in 987. Salomon Brothers, First eston and Merrill Lynch each oved down a notch, taking seond, third and fourth place.

Drexel's volume once again warfed all the rest in the area it ngendered — non-investmentrade issues — accounting for 1.907 billion, a slight increase om 1987's $11.623 billion.

First Boston and Morgan Stany switched place in 1988; First oston ranked second with $3.908 illion and Morgan Stanley slipped third with $3.133 billion.

Firms with strong retail operaons dominated the equity ranks - a boon to Merrill Lynch. Closed-end products cooked up a ay to sustain the volume of muual funds" in a year when retail ivestors avoided conventional pen-end mutual funds, Mr. eefe, the Drexel analyst, said.

Prudential-Bache shot up to th place with $1.182 billion m 15th place in 1987 when it d only $48.8 million. Goldman, chs, skidded to seventh place om fifth place as its volume ore than halved to $805.2 milon from $1.975 billion in 1987.

Merrill Lynch remained No. 1 in itial public offering volume, with stellar 71% increase to $4.348 illion from $2.54 billion in 1987.

Shearson Lehman Hutton Inc. umped to second from fifth place, oubling its volume to $4.044 billion rom $2.081 billion with less than alf the amount of issues.

Prudential-Bache surged to hird place from eighth with 3.194 billion in initial public ofering volume, up from $938.4 illion in 1987.

Merrill Lynch dominated comon stock underwriting with 4.962 billion, up from $4.416 illion in 1987. Last year's leader, Goldman Sachs, sank to No. 6 ith $2.068 billion in volume — ess than one-third its 1987 total f $6.653 billion.

Shearson Lehman Hutton rose o the No. 2 spot with $4.67 illion vs. $3.536 billion in 1987. rudential-Bache again stole the how, rising to third place with 3.325 billion from $1.135 billion n 1987, when it ranked 12th. ■

# 1988 underwriting rankings

## (Full credit to lead manager)

### All issues - global*

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Merrill Lynch (3) | 46,247.6 | 9.6 |
| 2. First Boston/CSFB** (1) | 44,801.4 | 9.3 |
| 3. Goldman, Sachs (5) | 41,484.2 | 8.6 |
| 4. Salomon Brothers (2) | 39,305.8 | 8.1 |
| 5. Shearson Lehman (6) | 27,561.6 | 5.7 |
| 6. Morgan Stanley (4) | 27,310.7 | 5.6 |
| 7. Drexel Burnham (7) | 21,334.4 | 4.4 |
| 8. Nomura (8) | 19,801.8 | 4.1 |
| 9. Deutsche Bank (12) | 13,289.9 | 2.7 |
| 10. Prudential-Bache (18) | 11,808.7 | 2.4 |

* All taxable issues, debt and equity, worldwide
** First Boston/Credit Suisse First Boston
Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### All issues - domestic*

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Merrill Lynch (3) | 39,699.4 | 14.5 |
| 2. Goldman, Sachs (4) | 36,887.6 | 13.5 |
| 3. Salomon Brothers (1) | 33,929.4 | 12.4 |
| 4. First Boston (2) | 29,938.2 | 11 |
| 5. Shearson Lehman (6) | 25,720 | 9.4 |
| 6. Morgan Stanley (5) | 22,958.9 | 8.4 |
| 7. Drexel Burnham (7) | 20,923.4 | 7.7 |
| 8. Prudential-Bache (10) | 11,033.7 | 4 |
| 9. Bear, Stearns (9) | 9,149.2 | 3.3 |
| 10. Kidder, Peabody (8) | 7,110.2 | 2.6 |

* All taxable issues, debt and equity, sold in U.S. only
Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### All issues - domestic*

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Merrill Lynch (1) | 28,916.3 | 18.1 |
| 2. Salomon Brothers (4) | 18,020.8 | 11.3 |
| 3. Goldman, Sachs (2) | 17,882.1 | 11.2 |
| 4. Shearson Lehman (7) | 17,116.4 | 10.7 |
| 5. First Boston (5) | 16,594.9 | 10.4 |
| 6. Drexel Burnham (6) | 15,132.2 | 9.5 |
| 7. Morgan Stanley (3) | 14,845 | 9.3 |
| 8. Prudential-Bache (12) | 4,827.6 | 3 |
| 9. Kidder, Peabody (8) | 4,061.9 | 2.5 |
| 10. Smith Barney (9) | 3,883.8 | 2.4 |

* All taxable issues, debt and equity, excluding mortgage-related and agency issues, sold in U.S. only
Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### All debt issues

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Gold[illegible] (5) | 34,029.8 | 14.4 |
| 2. Salom[illegible] (1) | 32,275.8 | 13.6 |
| 3. Merrill Ly[illegible] | 32,272.3 | 13.6 |
| 4. First Bosto[illegible] | 28,255 | 11.9 |
| 5. Morgan Stanley (4) | 22,061.2 | 9.3 |
| 6. Shearson Lehman (6) | 20,155.3 | 8.5 |
| 7. Drexel Burnham (7) | 18,886.1 | 8 |
| 8. Bear, Stearns (9) | 8,974.3 | 3.8 |
| 9. Prudential-Bache (10) | 7,689.1 | 3.3 |
| 10. Kidder, Peabody (8) | 6,071.4 | 2.6 |

Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### Non-investment grade debt

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Drexel Burnham (1) | 11,906.7 | 42.8 |
| 2. First Boston (3) | 3,908.1 | 14.1 |
| 3. Morgan Stanley (2) | 3,132.7 | 11.3 |
| 4. Merrill Lynch (4) | 2,097.5 | 7.5 |
| 5. Salomon Brothers (6) | 1,751 | 6.3 |
| 6. Prudential-Bache (15) | 1,181.7 | 4.2 |
| 7. Goldman, Sachs (5) | 805.2 | 2.9 |
| 8. DLJ (8) | 776.3 | 2.8 |
| 9. Smith Barney (11) | 696.1 | 2.5 |
| 10. Kidder, Peabody (7) | 551 | 2 |

Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### Mortgage-related debt

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Goldman, Sachs (4) | 16,886.7 | 17.5 |
| 2. Salomon Brothers (1) | 12,964.6 | 13.4 |
| 3. First Boston (2) | 9,458 | 9.8 |
| 4. Merrill Lynch (3) | 9,094.2 | 9.4 |
| 5. Shearson Lehman (5) | 8,387.6 | 8.7 |
| 6. Morgan Stanley (6) | 7,699 | 8 |
| 7. Bear, Stearns (9) | 7,569 | 7.8 |
| 8. Prudential-Bache (10) | 6,206.1 | 6.4 |
| 9. Drexel Burnham (8) | 4,486.3 | 4.6 |
| 10. Kidder, Peabody (7) | 2,943.4 | 3 |

Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### Initial public offerings

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Merrill Lynch (1) | 4,348.2 | 18.6 |
| 2. Shearson Lehman (5) | 4,043.5 | 17.3 |
| 3. Prudential-Bache (8) | 3,193.8 | 13.7 |
| 4. PaineWebber (11) | 2,789.1 | 12 |
| 5. Wheat, First Securities (2) | 2,150 | 9.2 |
| 6. Goldman, Sachs (3) | 1,304.6 | 5.6 |
| 7. Alex. Brown & Sons (4) | 1,061.7 | 4.6 |
| 8. Drexel Burnham (7) | 668.1 | 2.9 |
| 9. First Boston (10) | 584.8 | 2.5 |
| 10. Salomon Brothers (6) | 517.3 | 2.2 |

Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### Common stock

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Merrill Lynch (2) | 4,962 | 16.8 |
| 2. Shearson Lehman (3) | 4,670 | 15.8 |
| 3. Prudential-Bache (12) | 3,324.6 | 11.2 |
| 4. PaineWebber (13) | 2,856.4 | 9.6 |
| 5. Wheat, First Securities (6) | 2,150 | 7.3 |
| 6. Goldman, Sachs (1) | 2,067.8 | 7 |
| 7. Drexel Burnham (7) | 1,803.4 | 6.1 |
| 8. Alex. Brown & Sons (4) | 1,176.4 | 4 |
| 9. Salomon Brothers (9) | 1,077.6 | 3.6 |
| 10. First Boston (5) | 853.3 | 2.9 |

Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

### Preferred stock

| Firm | Volume $ mils. | Market share (%) |
|---|---|---|
| 1. Merrill Lynch (4) | 2,465 | 33.7 |
| 2. Shearson Lehman (7) | 894.7 | 12.2 |
| 3. First Boston (3) | 853 | 11.7 |
| 4. Goldman, Sachs (2) | 790 | 10.8 |
| 5. Kidder, Peabody (6) | 634 | 8.7 |
| 6. Salomon Brothers (5) | 576 | 7.9 |
| 7. Morgan Stanley (1) | 359.9 | 4.9 |
| 8. Drexel Burnham (8) | 233.9 | 3.2 |
| 9. Smith Barney (NA) | 135 | 1.8 |
| 10. DLJ (12) | 109.1 | 1.5 |

Source: IDD Information Services, New York
Numbers in parentheses show the firm's 1987 ranking

# LBOs tarnished

*Continued from page 1*

The largest public fund, the $46 billion California Public Employees' Retirement System in Sacramento, is seriously considering entering the leveraged buy-out market in 1989.

Basil Schwan, assistant executive officer, said the board will be presented in January with a working draft of a policy that says there are opportunities in "selective" leveraged buy-out investments.

"We think that the LBOs, if selected carefully and with care, offer a good return opportunity," he said.

The leveraged buy-out field has attracted much notoriety of late with the $25 billion leveraged buy-out of RJR Nabisco Inc. Members of Congress have indicated they will hold hearings this year on the use of pension money for leveraged buy-outs.

One fierce critic of leveraged buy-outs is Wm. Irwin Arbuckle II, vice president for investment and treasurer of the $2 billion Board of Pensions of the Presbyterian Church (U.S.A.) in Philadelphia. Mr. Arbuckle said he hopes Congress gets involved because he fears for the safety of workers' pensions.

"We haven't gone through a recession yet," he said. "I define a recession as 12 consecutive quarters of down GNP. If that happens, practically all the LBO (companies) would be bankrupt."

Mr. Arbuckle is strongly critical of the fees investment bankers receive up front before the company proves the buy-out was beneficial.

"It's legalized theft: theft from stockholders; theft from employees; theft from vendors; and more especially, theft from bondholders."

"I think it's a crime. I pray that Congress imprisons those responsible. It's ruining the financial industry."

One who is not critical but at least temporarily has stayed out of investments in leveraged buy-outs is Marshall Burkes, executive director of the Wisconsin Investment Board, Madison. Wisconsin made no new buy-out investments last year, and has committed $700 million over the years.

"The feeling was that there was too much money committed to an increasing number of funds."

The Michigan State Employees' Retirement Systems, Lansing, has been pleased with the performance of about $200 million drawn from its $400 million commitment to LBOs, but will seek a provision in future contracts that its assets not be used in hostile takeovers, according to Robert Kolt, public affairs officer for Robert Bowman, state treasurer.

Mr. Bowman also plans to develop a policy under which the state pension fund would buy stock of Michigan-based companies that are the subject of hostile bids, in order to defend these companies against hostile takeovers, Mr. Kolt said.

The Oregon Public Employes Retirement System, Salem, still has about half of its $600 million commitment to leveraged buy-outs uninvested. James George, investment manager, said he couldn't guess how buy-outs will perform in 1989, but he thinks the increasing amount of assets committed to the area does not necessarily mean returns will fall.

"It's a one-deal-at-a-time investment business," he said. "It doesn't preclude any transaction from being profitable or not profitable."

James Biundo, executive director of trust investment management for U S WEST Inc., Englewood, Colo., said his $8.1 billion fund n had considered leveraged buy-out investments, but hasn't made any so far because he hasn't figured out how to characterize them.

"We haven't figured out how to rationalize them (LBOs) as true investments," he said. "With venture capital, our people stay very close to the management of the investment. It's not the same with LBOs." ■

PENSIONS &

January 23, 1989

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**INSIDE: The 1,000 largest pension funds**

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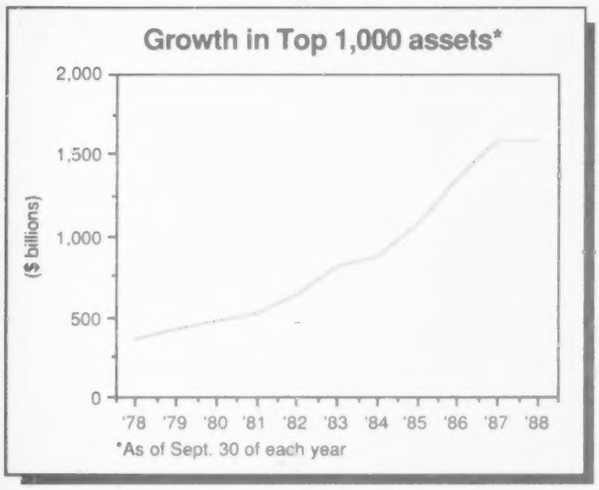
January 23, 1989

# Investment Age

The newspaper of corporate and institutional investing $110 a year

# Cash flow, growth lag




## Contribution drop to hit market

By Fred Williams

Contributions to public pension funds are starting to dry up, prompting concern that a major source of cash flow to the capital markets will evaporate.

Fueled largely by the loosening of investment restrictions and the availability of cash flow, public pension funds had been the second largest buyers of common stock — second only to corporations buying back their own stock — since 1985. Public funds pumped $105.8 billion into the stock market during 1987 alone and $53.8 billion during the first three quarters of 1988, according to the Federal Reserve Board.

During much of the same period other markets also were fueled by the cash flow from public funds, which lagged their corporate counterparts in moving into such asset classes as real estate and international.

At the same time, a raging bull market helped turn corporate funds into significant sellers of stock, as they lowered contributions, raised interest-rate assumptions and locked up gains. Mutual funds and individual investors, many of whom turned to the fixed-income markets, also were net equity sellers.

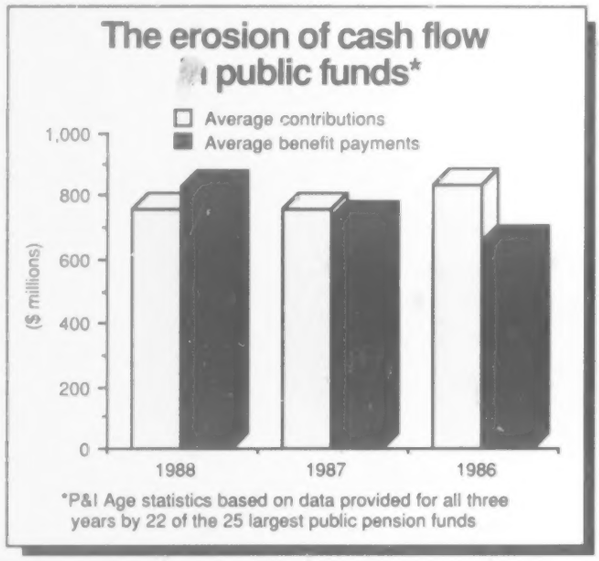
Public fund cash flow (which a pension fund derives from contributions from its sponsor and investment income) is eroding even more because benefit payments to participants are increasing, so many public funds are withdrawing more money than they are depositing.

Statistics compiled by *Pensions & Investment Age* show the average contribution for 22 of the largest public funds declined 9.4% in three years, to $755.3 million in 1988 from $760.3 million in 1987 and $833.4 million in 1986. Benefit payments, meanwhile, grew an average of 25.7% during the same period, to $828 million in 1988 from $734.7 million in 1987 and $658.7 million in 1986, according to *P&I Age* data. Research by the Employee Benefit Research Institute, Washington, on the other hand, shows public fund contributions increased between 1984 and 1987, but at a slower rate each year.

Contributions are slowing for a cornucopia of reasons, many of which affected corporate pension funds several years earlier:

- Plans are becoming more fully funded; that is, the amount of assets is catching

*Continued on page 90*




## Assets' rise halted

By Carol Wiley

Asset growth of the nation's 1,000 largest employee benefit funds ground to a virtual halt in the year ended Sept. 30 — a period that includes the worst stock market crash in history.

The period marked the slowest one-year growth rate since *Pensions & Investment Age* began tracking the data in 1977.

What little growth there was came from defined contribution plans, especially thrift and savings plans and 401(k) plans. Defined benefit assets declined.

Total assets as of Sept. 30 were $1.586 trillion, up 0.5% from the previous year's $1.578 trillion. Assets of the 200 largest funds rose 0.3% to $1.202 trillion from $1.198 trillion a year earlier. Assets of the Bottom 800 increased 0.9%, to $383.41 billion from $380.1 billion.

The turbulent market at the beginning of the 12-month period and the recovery in the months that followed contributed to slow growth, consultants said.

Greater exposure to the equity market by defined benefit plan assets, which represent the largest portion of the total pension assets, helped to bring total assets down, said Ron Jones, partner of Hewitt Associates, Lincolnshire, Ill.

*Continued on page 91*

# ESOPs gaining more forceful roles

By Barry B. Burr

Encouraged by Procter & Gamble Co.'s move and the Polaroid Corp. court ruling, more corporations are expected to set up leveraged employee stock ownership plans to protect against unwanted takeovers and to cut employee benefit costs.

Leveraged ESOPs are being viewed not only as an anti-takeover device, the central issue in the recent Polaroid ruling, but also as a way of providing the same benefits at less cost by using additional tax advantages.

Adapting a design suggested by Goldman, Sachs & Co., New York, Cincinnati-based Procter & Gamble will make a leveraged ESOP part of its existing profit-sharing plan. As a result, said J.R. Smith, Procter & Gamble's manager-pension plan coordination, P&G will receive additional tax benefits and cut its pension cost for making the same amount-of contributions it had been making to its profit-sharing plan alone. Employees will receive the same projected benefits under the newly combined ESOP profit-sharing plan, he added.

Goldman, Sachs — Procter & Gamble's chief investment banker — "was actually more responsible in coming to us and suggesting (the leveraged ESOP) to us," said Mr. Smith.

Goldman officials also are assisting with obtaining financing for the ESOP through private placements, mainly from insurance companies.

Procter & Gamble might have been more motivated by costs than the anti-takeover issue because the profit-sharing plan already holds 14% of the stock, suggested Corey Rosen, executive director of the National Center for Employee Ownership, Oakland, Calif.

In a sense, Mr. Smith indicated, Procter & Gamble is waking up to tax advantages available since the tax reform legislation of 1986.

"Recent legislation has allowed companies to use dividends to pay off a leveraged ESOP loan and get tax deductions," he said. "We've become more aware of it and we see the advantages of the program."

Procter & Gamble's profit-sharing contribution totaled about $180 million on a pre-tax basis last year. With the additional ESOP tax advantages, he said the cost to the company of making the same contribution will be less, although he declined to estimate the reduction.

"There's been a lot of companies interested in this," said Karen W. Brown, group vice president at Duff & Phelps Inc., Chicago. "We expect to see more companies do this."

Speaking in general about the plan, Ms. Brown said: "Through the leveraged purchase of equities, companies are pre-funding their pension obligations at a lower net cost. The company is buying today all the stock it wants to contribute to the fund. It's cheaper than purchasing stock over time gradually" at a higher price, presuming it rises in value.

"I'll wager you'll hear other major announcements" of companies forming similar leveraged ESOPs, said Mr.

*Continued on page 91*

## LATE NEWS

### Hooks resigns from Texas fund

AUSTIN, Texas — Jim Hooks, investment officer for the $8 billion Texas Permanent School Fund, resigned Dec. 31 after 15 years with the fund.

Walter Arellano, assistant investment officer, is serving as acting investment officer until a permanent replacement for Mr. Hooks is named by the fund's board of trustees.

Mr. Hooks said he had no immediate plans, but that he left because he wanted a change of pace.

Mr. Arellano said he has applied for the job. He said the board has assigned a committee to oversee the naming of a new investment officer. The board is expected to make its selection in February or March.

### Deutz-Allis taps 3 for $15 million

MILWAUKEE — Deutz-Allis Corp. has hired three managers to run portfolios for two pension plans and a 401(k) plan, said Ed Walker, director of finance.

Hired to run the entire $8.5 million pension plan for hourly workers was Cashman, Farrell and Associates, Wayne, Pa., and to manage the $4.5 million pension plan for salaried employees was Lowe, Brockenbrough, Tierney & Tattersall, Richmond, Va.

Picked to run the $2 million equity portion of its $19 million 401(k) plan for salaried employees was GAMCO Investors Inc., New York. The remainder is invested in guaranteed investment contracts.

Mellon Equity Associates, Pittsburgh, previously ran the assets involved from the three plans.

Morgan Keegan & Co. Inc., Atlanta, Ga., was the consultant used for the manager selections.

### College searching for realty firm

BEREA, Ky. — Trustees of the $226 million Berea College endowment fund are expected to hire a real estate manager from a group of three managers now under consideration, said Ted Jennings, assistant controller.

Cambridge Associates, Boston, is assisting in the search, he added.

Mr. Jennings, who declined to name the three finalists, said a decision is expected at the trustees' board meeting near the end of January. He said the amount of the potential funding for the new manager hasn't been determined.

The fund already has an undisclosed portion in real estate run by HLM Management Co. and T.A. Associates, both of Boston.

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**Cover:** Left to right, descending: John Carroll and Dave Bullett (photographed by John Kennard), and Dale Hanson (photographed by Linda Sue Scott); design by Kristina M. Schramm.

## Questionnaires to be mailed

**Questionnaires for the 1989 Investment Advisers profile issue will be sent out Feb. 1. If you were not included in last year's issue and wish to receive a questionnaire this year, please contact Christine Philip, directory coordinator, at *Pensions & Investment Age*, 740 N. Rush St., Chicago, Ill. 60611-2590; (312) 649-5217.**

# Tender-offer guide

## Clarification delayed; little impact seen

By Joel Chernoff

WASHINGTON — Investment practices likely won't change when the Labor and Treasury departments clarify that private pension plan fiduciaries are not required to sell their shares in a tender offer or leveraged buy-out.

"Can you imagine going before an investment committee when you had the stock at 70, the tender was at 90 (you decided not to sell) and now it's back at 60?" asked Charles H. Salisbury Jr., vice president and director of T. Rowe Price Associates Inc., Baltimore.

Robert A.G. Monks, formerly head of the Labor Department's pension program and now president of Institutional Shareholder Services Inc., Washington, agreed. "It's simply so difficult for a money manager to act in his own interest by not tendering," he said.

The government's policy "is not going to be self-executing," Mr. Monks added.

But pension executives will have to wait for the Bush administration to inform them of their full responsibilities under the law.

The planned release of a joint statement by departments last week was scuttled at the 11th h because of political reasons.

Officials decided it would be "more appropriate be done at the beginning of the Bush administrat than at the end of the Reagan administration," explained David M. Walker, assistant secretary for Labor Department's Pension and Welfare Bene Administration.

The statement will be part of the new administ tion's focus on making U.S. business more co petitive, he said.

Growing concern has been expressed by gove ment officials about the leveraging of corpor America. Nine congressional committees are abou hold hearings on corporate takeovers, leveraged b outs and the shift toward debt from equity.

Some observers believe a number of pension p fessionals "are acting in an overly short-sighted myopic manner," explained Mr. Walker.

"It is important that pension plans conduct the

*Continued on page*

# IRS clips wings of Eastern

By Joel Chernoff

WASHINGTON — The Internal Revenue Service has thrown a monkey wrench into the financing plans of Eastern Air Lines Inc., requiring the troubled company to make a $105 million contribution to its underfunded pension plan by Sept. 15.

In addition, the airline must pay the fund part of the proceeds from any asset sales.

The requirements were imposed by the IRS in granting a one-year waiver of the pension obligation, during which it rejected a request by Miami-based Eastern to extend the pension payments over a five-year period.

As of Dec. 31, 1987, Eastern had pension assets of $1.2 billion and liabilities of $1.5 billion.

The effect of the conditional waiver likely will be to further hasten the sale of Eastern's assets and erode the company's cash reserves. As of Sept. 30, Eastern had cash and marketable securities of $387.1 million.

The airline was given until Sept. 15 to make its 1987 plan year contribution, which originally had been due in September 1988. The waiver also covers partial repayment of a $60.4 million waiver granted for the 1985 plan year.

The IRS also is requiring Eastern to contribute a percentage of any asset sales made on or after Dec. 15, 1988, to the plan within 30 days of any transaction, effectively accelerating repayment. In addition, Eastern will have to secure the waived contribution, although the company is negotiating with the government on the collateral.

The hard line taken by the IRS reflects tougher rules imposed on funding waivers by the Pens Protection Act of 1987, exp said. "Under the '87 law, you h to fac in the determinatio whether the company will be to repay" the deferred contri tion, said Leonard Hirsh, a p ner in the law firm of Parker C pin Flattau & Klimpl, New Yo

Previously, an employer had show it was experiencing "s stantial business hardship." N an employer must show evide the company — as well as oth under common control — is vi in the long run.

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**Eastern Air Lines will have to contribute $105 million to its pensi fund as part of the terms of the IRS' latest funding waiver.**

# Private debt revalued

By Marlene Givant Star

More institutional investors are marking to market their privately placed bonds, paving the way for greater market liquidity, new participants and better asset/liability management by insurance companies.

As market valuation of private debt gains in popularity, mutual funds could introduce products specializing in the securities and insurers would be able to establish track records with which to market new private placement products.

Although until recently marking to market largely has been a guessing game, "there's an emerging interest on the part of most insurance companies" to do so, said Jack Cartland, managing director-private finance of Aetna Life Insurance Co., Hartford, Conn., which has $11 billion in private placements.

As the process gains popularity, issuers wary of private deals because of a lack of market valuations for the unregistered securities might t the market.

"It's just another element of making the market more efficient. Issuers are looking for the most efficient transaction. To the extent it makes the buyer more competitive, it might bring more issuers to the market," said Joel Glasky, head of private placements at Shearson Lehman Hutton Inc., New York.

By marking to market both their private placement assets and corresponding liabilities such as guaranteed investment contracts, insurers — the dominant investors in private deals — would keep better tabs on their balance sheets.

Insurance companies typic carry private placements on t books at amortized cost rat than market. Only New York quires insurance companies match interest rate-sensit assets to liabilities for purpose reporting to the state insura commissioner.

The Prudential Insurance Co America, Newark, N.J.; The T velers Cos., Hartford, Conn.; Aetna are among the few ins ance companies that mark market on a regular basis.

The plight of the savings loan industry has highlighted importance of asset/liabi matching, according to observe

"Most of the debacles in fin cial services in the last 10 y could have been avoided by u a market valuation appro across the whole balance she

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